



DEPARTMENT OF THE TREASURY

Internal Revenue Service
TE/GE EO Examinations
1100 Commerce Street
Dallas, TX 75424

501.03-00

**TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION**

April 13, 2010

Release Number: **201032050**

Release Date: 8/13/2010

LEGEND

ORG = Organization name XX = Date Address = address

ORG
ADDRESS

Person to Contact:
Identification Number:
Contact Telephone Number:
In Reply Refer to: TE/GE Review Staff
EIN:

CERTIFIED MAIL – RETURN RECEIPT

LAST DATE FOR FILING A PETITION
WITH THE TAX COURT: July 12, 20XX

Dear :

This is a Final Adverse Determination Letter as to your exempt status under section 501(c)(3) of the Internal Revenue Code. Your exemption from Federal income tax under section 501(c)(3) of the code is hereby revoked effective January 1, 20XX. You have agreed to this change per signing of the Form 6018, dated March 2, 20XX.

Our adverse determination was made for the following reasons:

You have not demonstrated that you are operated exclusively for charitable, educational, or other exempt purposes within the meaning of I.R.C. section 501(c)(3). ORG also is not a charitable organization within the meaning of Treasury Regulations section 1.501(c)(3)-1(d). You failed to comply with the conditions of your exemption in that you operated a charitable organization as a commercial entity. You have provided no information showing that you conduct a real and substantial charitable program.

You failed to meet the requirements of IRC section 501(c)(3) and Treas. Reg. section 1.501(c)(3)-1(d) in that you failed to establish that you were operated exclusively for an exempt purpose. Rather, you were operated for a substantial non-exempt purpose; operating a private practice for the benefit of the organization's therapist and officers.

Contributions to your organization are no longer deductible under section 170 of the Internal Revenue Code. You are required to file Federal income tax returns on Form 1120. These returns should be filed with the appropriate Service Center for the year ending December 31, 20XX, and for all years thereafter.

Processing of income tax returns and assessment of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Internal Revenue Code.

If you decide to contest this determination in court, you must initiate a suit for declaratory judgment in the United States Tax Court, the United States Claim Court or the District Court of the United States for the District of Columbia before the 91st day after the date this determination was mailed to you. Contact the clerk of the appropriate court for the rules for initiating suits for declaratory judgment.

You also have the right to contact the office of the Taxpayer Advocate. However, you should first contact the person whose name and telephone number are shown above since this person can access your tax information and can help you get answers.

You can call 1-877-777-4778 and ask for Taxpayer Advocate assistance. Or you can contact the Taxpayer Advocate from the site where the tax deficiency was determined by calling; or writing:

Taxpayer Advocate assistance cannot be used as a substitute for established IRS procedures, formal appeals processes, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determinations, nor extend the time fixed by law that you have to file a petition in the United States Tax Court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling.

We will notify the appropriate State Officials of this action, as required by section 6104(c) of the Internal Revenue Code.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely yours,

Nanette M. Downing
Director EO Examinations



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY

Internal Revenue Service
TE/GE:EO:Examinations
701 B Street, Suite 902
San Diego, CA 92101

December 14, 2009

ORG
ADDRESS

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Certified Mail - Return Receipt Requested

Dear :

We have enclosed a copy of our report of examination explaining why we believe revocation of your exempt status under section 501(c)(3) of the Internal Revenue Code (Code) is necessary.

If you accept our findings, take no further action. We will issue a final revocation letter.

If you do not agree with our proposed revocation, you must submit to us a written request for Appeals Office consideration within 30 days from the date of this letter to protest our decision. Your protest should include a statement of the facts, the applicable law, and arguments in support of your position.

An Appeals officer will review your case. The Appeals office is independent of the Director, EO Examinations. The Appeals Office resolves most disputes informally and promptly. The enclosed Publication 3498, *The Examination Process*, and Publication 892, *Exempt Organizations Appeal Procedures for Unagreed Issues*, explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

You may also request that we refer this matter for technical advice as explained in Publication 892. If we issue a determination letter to you based on technical advice, no further administrative appeal is available to you within the IRS regarding the issue that was the subject of the technical advice.

If we do not hear from you within 30 days from the date of this letter, we will process your case based on the recommendations shown in the report of examination. If you do not protest this proposed determination within 30 days from the date of this letter, the IRS will consider it to be a failure to exhaust your available administrative remedies. Section 7428(b)(2) of the Code provides, in part: "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted its administrative remedies within the Internal Revenue Service." We will then issue a final revocation letter. We will also notify the appropriate state officials of the revocation in accordance with section 6104(c) of the Code.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Nanette M. Downing
Acting Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination

Form 886-A (Rev. January 19XX)	EXPLANATION OF ITEMS	Schedule number or exhibit
Name of Taxpayer ORG	Tax Identification Number	Year/Period ended December 31, 20XX

LEGEND

ORG = Organization name XX = Date Address = address City = city State = state website = website RA-1, RA-2 & RA-3 = 1st, 2nd & 3rd RA President = President Secretary = secretary DIR-1, DIR-2, DIR-3 & DIR-4 = 1st, 2nd, 3rd & 4th DIRECTORS PT-1, PT-2, PT-3, PT-4, PT-5, PT-6, PT-7, PT-8, PT-9, PT-10 & PT-11 = 1st, 2nd, 3rd, 4th, 5th, 6th, 7th, 8th, 9th, 10th & 11th PT co-1 THRU CO-66 = 1st THRY 66th COMPANY

ISSUE

To determine whether ORG ("ORG") operated exclusively for tax exempt purposes within the meaning of IRC § 501(c)(3), 509(a)(2)

FACTS

Organization

ORG was incorporated on August 29, 19XX. The purpose of the organization is "to provide professional psychological counseling, therapy, and educational services to individuals and families."

ORG applied for tax exempt status and received recognition as an organization exempt under IRC § 501(c)(3) and 509(a)(2) in May of 19XX.

Board of Directors

The following individuals are the current members of ORG's Board of Directors:

President, President
Secretary, Secretary
DIR-1, Director
DIR-2, Director
DIR-3, Director
DIR-4, Director

President ("President") is the founder of ORG. Secretary ("Secretary") is his wife. None of the other board members are related to President and Secretary or to one another.

Based on ORG's current bylaws, less than a majority vote from the Board of Directors is required to establish a quorum. Two votes from any combination of the six board members listed above will consist of a quorum.

During the examination, President explained that board meetings are supposed to be held annually, but there have been lapses in meetings. Secretary further explained that the Board of Directors does not engage in any of the decision making activities for ORG. President and Secretary will meet with the Board of Directors to discuss the practices of the organization. The Board members are entitled to make

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suggestions to which the ORG staff will take into consideration but are not required to execute.

According to ORG's authorized representative, RA-1, the organization has not held any Board meetings since the 19XXs. Subsequent to the start of the examination, ORG held a meeting of the Board of Directors on January 17, 20XX to bring the organization's minutes up to date. ORG lost contact with and was unable to locate two of its original board members, whom had to be replaced at the time of the meeting.

History

Prior to the creation of ORG, President operated an individual practice. President started off by attending church town counsel meetings and conducting networking activities with community organizations in the City area of State. Soon, President created ORG, which quickly became popular as a resource for mental healthcare. At the time, President was working with social service groups, doctors, physicians, and school counselors. As ORG grew, the organization also began to offer monthly office seminars and newsletters. ORG also offered "Kids at Risk" counseling, parent counseling, and supervision services for problematic cases at the family service center at the City military base. At the same time, ORG acted as a resource for pastors and school personnel and was often invited to schools to speak.

In 19XX, ORG decided to apply for a grant offered by the City of State for the treatment of troubled juveniles. Consequently, ORG was required to apply for tax exempt status with the IRS. Although ORG did not win the grant, ORG continued to retain its tax exempt status in light of the organization's other community-related activities. As provided by President and Secretary, ORG was involved in a variety of community work, which continued through the 19XXs and 19XXs.

Current Activities

ORG operates a mental health care facility located at Address, City, State . President also sees patients in a County office located at Address, City, State.

Based on the minutes of the meeting dated January 17, 20XX, ORG was founded on reduced fees for clients and a variety of free psychological wellness materials to augment patient care. According to the organization, those basic services remain today despite changes in the health care field and service delivery.

ORG does not maintain any professional licenses with the State of State. Individual licenses are maintained by each therapist as is required by law. Through its therapists, ORG offers a wide variety of services and specializes in, among other things, "gay and lesbian counseling, pet therapy, Jewish family services, and child therapy." ORG's target clientele are patients for general outpatient mental health care. The organization offers services to all individuals, couples, families, and groups (i.e. military families).

According to President and Secretary, ORG's primary activity involves seeing patients who are on managed care (i.e. insurance) plans. During the examination, President explained that managed care has

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changed since the organization commenced operations in the 19XXs. The focus has changed from who you know to what insurance panel you are on. As an example, President explained that it would not matter if and how much a school counselor likes him if he is not on the panel for a particular student's managed care plan. Thus, ORG is enrolled in a wide variety of managed care plans and agrees to the reduced contract fees for each plan.

In addition to accepting the contracted rates from each managed care plan, ORG offers discounts to patients who do not have any insurance and only require short-term treatment. If long term treatment is required, ORG will help the individual find a place in the community (i.e. CO-1, CO-2's CO-3, or CO-4) that receives funding for such purposes. ORG may also refer individuals to on-campus counseling for help.

Due to heightened military security, ORG no longer offers services to the City military base. In addition, ORG no longer offers counseling services directly to the schools. Nevertheless, the organization may intermittently coordinate with the family services center and school counselors. During these meetings, ORG will talk about the organization's expertise as service providers, inform them of the managed care plans that ORG accepts, and remind them that ORG's door is open.

ORG has also discontinued offering seminars at this time. Secretary explained that on one occasion, she set up a couple's communication workshop that was discovered and announced to the public by a radio show host. Twenty-five couples signed up, but no one showed up for the meeting. From this experience, President and Secretary determined that people do not value free counseling. Because they did not wish to charge for ORG's outreach services, they decided to discontinue offering free seminars. In lieu of these community service activities, ORG now offers information dissemination through its website.

Website

During the examination, President and Secretary explained that ORG's community service activities (i.e. seminars and newsletters offered in earlier years) have been replaced by the organization's website located at website. ORG promotes its website through the dissemination of business cards and handouts. All of the materials presented on the website are offered free of charge and do not require signing up or logging in.

Based on the organization's website, ORG offers the following services:

Parenting education Group psychotherapy Military families Sex therapy Community education
 Child psychology Adolescent psychology Adulthood psychology Psychological and intellectual
 assessment

Aside from general information about the organization and links to other mental health resources, ORG's website also provides self-help articles on a variety of topics related to mental health. Currently, ORG's website offers self-help and wellness material and articles in the following five categories:

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Addiction and Recovery Interpersonal Relationships Coping with Change Domestic Violence Relationship Test

All of the articles posted on ORG's website were collected from workshops or quarterly newsletters printed by ORG in the past. Some of the articles were written by the ORG staff with administrative oversight from President and Secretary. Other articles were purchased from CO-5 and were used as handouts during past workshops.

ORG's website also contains a "Contact Us" link that allows visitors to email the organization for more information. However, for the purposes of information security, ORG does not offer psychiatric help by e-mail. Instead, ORG offers a generic response to each individual regardless of the subject matter suggesting that the individual contact a local psychiatrist for personal treatment. ORG may or may not provide links to potential resources depending on availability. If the individual includes a local State phone number in the e-mail, ORG will call the individual to briefly discuss the situation and offer an office appointment for further consultation.

ORG has maintained limited documentation of past e-mail inquiries. In response to our request for information, ORG provided e-mail threads dated March 10, 20XX and March 22, 20XX. On both occasions, ORG offered general responses suggesting that the individual seek help from a local therapist.

According to the website, fees are based on usual and customary charges for each profession. In addition, ORG emphasizes that the organization is enrolled in dozens of managed care plans and offers the discounts that are appropriate to each plan. Furthermore, ORG offers to arrange a payment plan in the case of hardship.

Based on the organization's website, the organization accepts the following insurance plans:

CO-6	CO-35
CO-7	CO-36
CO-8	CO-37
CO-9	CO-38
CO-10	CO-39
CO-11	CO-40
CO-12	CO-41
CO-13	CO-42
CO-14	CO-43
CO-15	CO-44
CO-16	CO-45
CO-17	CO-46
CO-18	CO-47
CO-19	CO-48
CO-20	CO-49
CO-21	CO-50

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CO-22	CO-51	
CO-23	CO-52	
CO-24	CO-53	
CO-25	CO-54	
CO-26	CO-55	
CO-27	CO-56	
CO-28	CO-57	
CO-29	CO-58	
CO-30	CO-59	Even though
CO-31	CO-60	ORG accepts
CO-32	CO-62	Medi-Cal
CO-33	CO-63	(through CO-
CO-34	CO-64	65) and

Medicare, the organization does not explicitly advertise these health plans on its website.

An archive of the organization's website was obtained from website. The archived website revealed that the material currently offered on ORG's website is similar to the material posted on the organization's website when it was first implemented in 19XX. With the exception of three additional articles related to domestic violence, the same articles currently posted on the organization's website have been used since it was first put into operation.

Subsequent to the start of this examination, ORG has expressed extensive plans to expand the online wellness material posted on the organization's website. Such expansion will include the addition of articles on a variety of people and problems, as well as exercises for Life Skillbuilders. Moreover, the organization has expressed plans to resume newsletter dissemination through electronic means.

Sources of Revenue

ORG generates revenue from managed care reimbursement policies, patient co-payments, interests, and dividends.

ORG does not receive any grants to fund its activities, nor has the organization recently attempted to apply for any grants. ORG explained that the amount of time spent with a consultant is not a beneficial use of time because ORG would have to compete with major organizations that have interns from universities that can provide services to a broader range of patients.

ORG also determined that efforts for fundraisers (i.e. social events and local activities to raise money) would be counterproductive to time and resources best spent on direct patient care. Grant writing has required a substantial amount of financial cost and time but has not added to the benefits for ORG's patients.

A majority of the organization's revenue is generated from managed care reimbursements. Contracts with managed care companies (i.e. insurance companies) are maintained between the insurance company and

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each individual therapist that is accepted into the managed care panel. Under these contracts, patients may obtain services from ORG at a contracted rate. Patients are only responsible for their co-payments as required by the insurance company. If a patient expresses that he or she is unable to pay the insurance co-payment, the cost is negotiated between the patient and his or her therapist.

Expenses

Approximately ninety percent of the ORG's expenditures are paid out as wages to the organization's therapists and officers. Compensation rates for all therapists are considered standard in the industry. According to ORG, comparative data is gathered from therapists, administrators, and directors of health care practices in the community. Each therapist maintains a fee-split contract with ORG that takes into account the fixed overhead costs, office expenses, operating costs, maintenance costs, and other potential expenditures incurred by ORG.

Financials

During the examination, immaterial variances were found between the organization's books and records and the Form 990. However, wages paid to President was not properly allocated between his administrative duties as President of ORG and his professional duties as a therapist. Nevertheless, the information reported on Form 990 was determined reliable, and the return was accepted as filed. Accordingly, the following financial information reflects the numbers that were reported on the Form 990.

Balance Sheet

	BOY	EOY
--	-----	-----

Cash

Investments in publicly traded securities

Equipment (Notebook Computer)

Total Assets

Accounts Payable

Total Liabilities

Unrestricted assets

Total Liabilities & Net Assets/Fund Balances

Revenue:

Program service revenue

Interest from savings

Dividends and interest from securities

Other investment income

Gross amount from sales of assets

Gross amounts from sales of securities

Less cost

Gain (Loss)

Gross amounts from sales of other assets

Less cost

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Gain (Loss)

TOTAL REVENUE:

Expenses:

Compensation of current officers

Administration Fees Compensation

Therapist Fees Compensation

Salaries and wages of employees

Accounting Fees

Telephone - cell phones and office phone

Postage and Shipping

Occupancy - City and offices

Equipment rental and maintenance

Depreciation (notebook computer)

Other expenses

Bad Checks

Billing Services

Business Meals

Donation

Dues

Fees

Filing Fees/Franchise Tax Board

Insurance Refunds

Insurance, Business

Insurance, Liability

License

Rounding

Security

Subscriptions

Supplies

Tax, Foreign

Taxes, Property

Utilities

TOTAL EXPENSES

Staff members

ORG employs four therapists. These individuals include President, Secretary, RA-2, and RA-3. President and Secretary are also officers of ORG and offer administrative services to ORG in their capacity as officers. During the year under examination, Secretary was only compensated as an officer of ORG.

Aside from patient care, President's job description also includes:

- Networking with resources in the community (i.e. updating school counselors about resources in the office)
- Coordinating with managed care companies (i.e. updating insurance companies with new staff)

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availability and open spaces for patient care and renegotiating with insurance companies for higher contract rates)

- Billing patients for services
- Investigating and resolving insurance concerns
- Screening insurance coverage for benefits and authorization
- Meeting with new members of the community to introduce them to ORG's services
- Developing materials to inform the public of special services offered
- Reviewing patient statements for accuracy, maintaining therapy equipment
- Negotiating rental, billing, and cleaning contracts
- Providing teachers and school personnel with suggestions for IEP (Individualized Education Plans) planning
- Keeping accurate records for dates of services
- Attending conferences and meetings

Secretary's job description includes:

- Calling the insurance companies to screen and coordinate patient benefits (i.e. calling Blue Cross Blue Shield to verify that ORG is actually a provider for a particular plan that a patient is enrolled in)
- Checking for co-payments and deductibles and determining where claims should be mailed
- Determining the benefits a patient is entitled to and conveying this information to the therapists for proper treatment planning
- Processing payroll transactions
- Entering patients' data into the computer
- Maintaining pertinent records for confidentiality and accuracy
- Opening and handling mail
- Developing accurate reports for compensation of therapists
- Examining and keeping accurate financial records for each patient
- Calling insurance companies to resolve reimbursement conflicts
- Maintaining accounts payable and reconciling bank statements
- Purchasing supplies
- Keeping current on CEUs for educational, ethical, and treatment skills
- Providing individual, couples, and family treatment

RA-2's job description includes:

- Providing individual, couples, and family treatment
- Coordinating care with other providers and appropriate community members
- Providing psychological testing
- Providing patients and other appropriate individuals with results and recommendations.
- Working with families and the courts around custody issues
- Attending CEU seminars for updates on educational, ethical, and treatment issues
- Maintaining malpractice insurance and license
- Maintaining accurate and confidential treatment records

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RA-3's job description includes:

- Providing individual, couples, family and group treatment.
- Advising community members of group formation and seeking information or needs for future groups
- Coordinating care with other providers and appropriate community members
- Attending CEU seminars for updates on educational, ethical, and treatment issues
- Maintaining malpractice insurance and license
- Maintaining accurate and confidential treatment records

Fees

Although the documentation for such information is no longer readily available, ORG estimated that their usual and customary fees in the 19XXs ranged from \$ to \$ per 50 minute session. In the early 19XX's, ORG worked with low-fee patients represented by Medicaid and Medi-Cal. These low-fee patients were seen at rates as low as \$ per session.

ORG's usual and customary fees for the 20XX calendar year ranged from \$ to \$ per session. Such fees may be discounted to as little as \$ per session dependent upon the managed care plan's reimbursement policy. Currently, ORG offers services to low-fee patients through Medi-Cal (represented by CO-65) at a rate of \$ per session.

ORG's definition of a "minimal fee patient" is any patient who receives a discount of 50% or more off the usual and customary fees. According to President and Secretary, ORG accepts the lowest reimbursement rate available for all insurance companies.

Discounts

ORG submitted patient accounts receivable records for the year ending December 31, 20XX. The following calculations were made by the organization:

Total amount billed to patients	\$
Insurance payments received	\$
Patient payments and co-payments received	\$
Discounts offered by ORG	\$

For the 20XX calendar year, ORG provided counseling sessions to patients. Two hundred of the 214 patients were enrolled in a managed care plan. Fourteen of the patients did not have insurance. A majority of the discounts offered by ORG were provided as a part of the patients' insurance plans.

ORG claimed that services offered to the organization's patients are normally discounted to 50 percent based on the patient's managed care contract. These contracts allow some patients to obtain services at no

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additional charge (i.e. co-pays). Other contracts require that the patient submit a co-payment to ORG in addition to the payments made by the insurance company. However, analysis of the patient payment records obtained from ORG shows that a majority of the organization's patients actually paid more than 50 percent of the usual and customary fees that were billed to the patient.

Patients without insurance

ORG provided that it is abnormal for individuals who do not have insurance or who do not have the ability to pay to contact ORG directly. These individuals are often referred to ORG from low-fee referral agencies.

Patients without insurance are quoted the usual and customary fees. If the fees are unmanageable, ORG will offer the individual a 20 percent discount. If the patient expresses difficulty making payments with a 20 percent discount, the patient shows an ability to pay a reasonable fee under 20 percent, and ORG is able to offer the services that the patient requires, then ORG will arrange an appointment with the patient and will attempt to be liberal with fee reduction. ORG does not have any written policies for fee reduction. As each individual or family is the expert of their financial situation, the fee is uniquely tailored to each client.

Waived Fees

During the examination, ORG submitted a list of patients with waived fees. ORG does not have any formal policies or procedures for waiving fees. Fees waived for patients included defaulted co-payments and/or defaulted payments from managed care providers. ORG attempted but failed to collect payments from the patient or insurance company in each case. According to President and Secretary, the therapist and/or the director would assess the patient's financial and psychological condition and waive the balances in these situations.

The following individuals received waived fees during the 20XX calendar year:

Patient	Billed Amount	No. of Sessions	Insurance Payments	Patient Payments	Accounts Discounts	Receivable
PT-1						
PT-2						
PT-3						
PT-4						
PT-5						
PT-6						
PT-7						
PT-8						
PT-9						
PT-10						
PT-11						

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Non-billed meetings with professionals for patient care services

During the examination, ORG provided a list of “non-billed meetings with other professionals for patient care services.” ORG explained that these meetings were educational seminars on patient care on a variety of topics. These seminars were not related to any specific patient. These educational meetings were provided by healthcare experts for groups of five to 100 healthcare providers depending on the format of delivery. Face-to-face meetings were smaller, while teleconferences accommodated many more attendees.

Based on illustrations submitted by ORG, President attended various educational meetings during the 20XX calendar year. Supporting documentation revealed that these educational meetings provided President with continuing education credits for the 20XX calendar year.

Non-billed consultations regarding individual patients

During the examination, ORG submitted a list of “non-billed consultations regarding individual patients.” ORG explained that these consultations were conducted with other professionals who were contacted to enlarge the information collection for patient care or to coordinate treatment for patient care. Patients and therapists complete a “Release of Information” form to document permission to obtain and/or disclose information to other person(s). These non-billed consultations included:

- Contacting previous therapists to obtain relative background information for patient care.
- Sharing relevant information with workplace representatives for clients referred to ORG from their workplace for emotional fitness evaluations for the continuation of their jobs.
- Contacting referring professionals that may have briefly seen and referred the patient to ORG.
- Completing paperwork for patients’ disability application.
- Contacting a child’s school counselor or teachers to gather information for treatment planning and to coordinate ongoing care for the patient. ORG may also visit the school to watch the child in the classroom.
- Attending school consultation team meetings with educational professionals and parents to discuss behavioral and academic goals for a patient. Follow up meetings may also be held with school personnel to assess the child’s ongoing progress.
- Communicating with family doctors, pediatricians, and other psychiatrists to facilitate dosage and behavioral care for patients on psychotropic medications or other medical conditions. Elaborate discussions of symptoms are normally required between professionals to facilitate the progress of medication choice.
- Contacting family court services mediators for divorcing parents in the service of a child or adolescent. Extensive phone contact may be required between ORG and these mediators or the child’s attorney in order to discuss the patient’s psychological and legal care.

In some cases, a patient may be charged for consultations with other professionals (i.e. a lawyer or other professional) that require extensive written correspondence upon the patient’s request.

Volunteer activities

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President is currently enrolled in Psychology 20XX's patient program. Patients are required to provide one hour of volunteer community service for each hour of free psychological services received. Although President is currently enrolled in this program, no patients have been referred to him to date. Psychology 20XX offers no incentives to President for his time.

RA-3 is enrolled to see patients at the CO-66 (CO-66) Center; however, no patients have been referred to her to date. The CO-66 Center has created its own Behavioral Health Services and is less likely to refer patients to outside parties. The CO-66 Center offers no incentives to RA-3 for her enrollment. Review of the Center contract revealed that RA-3 agreed to a low-fee arrangement, which included a requirement to "maintain 2 low-fee slots (maximum \$) for Center referrals."

In addition to the above programs, ORG also receives referrals from several low-fee referral agencies. These include the State Access and Crisis Line, State Mental Health Care & Counseling, Behavioral Health Services, and CO-65 (Medi-Cal).

LAW & ARGUMENT

IRC § 501(c)(3) exempts from federal income tax corporations organized and operated exclusively for charitable, educational, and other purposes, provided that no part of the net earnings inure to the benefit of any private shareholder or individual.

Treas. Reg. § 1.501(c)(3)-1(d)(2) provides that the term charitable includes relief of the poor and distressed.

Treas. Reg. § 1.501(c)(3)-1(d)(3) provides that the term educational includes (a) instruction or training of the individual for the purpose of improving or developing his capabilities and (b) instruction of the public on subjects useful to the individual and beneficial to the community. In other words, the two components of education are public education and individual training.

Treas. Reg. § 1.501(c)(3)-1(a)(1) provides that, in order to be exempt as an organization described in IRC § 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) provides that an organization must establish that it serves a public rather than a private interest and "that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests." Prohibited private interests include those of unrelated third parties as well as insiders.

Treas. Reg. § 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities that

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accomplish one or more of such exempt purposes specified in IRC § 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. The existence of a substantial nonexempt purpose, regardless of the number or importance of exempt purposes, will cause failure of the operational test.

Rev. Rul. 56-185 provides, in part, that in order for a hospital to establish that it is exempt as a public charitable organization within the contemplation of section 501(c)(3), it must, among other things, show that it meets the following general requirements:

- It must be organized as a nonprofit charitable organization for the purpose of operating a hospital for the care of the sick.
- It must be operated to the extent of its financial ability for those not able to pay for the services rendered and not exclusively for those who are able and expected to pay.
- It must not restrict the use of its facilities to a particular group of physicians and surgeons, such as a medical partnership or association, to the exclusion of all other qualified doctors.
- Its net earnings must not inure directly or indirectly to the benefit of any private shareholder or individual.

Rev. Rul. 69-545 modifies Rev. Rul. 56-185 to remove the requirements that oblige health care organizations to care for patients without charge or at rates below cost. Rev. Rul. 69-545 provides, in part, that the promotion of health, like the relief of poverty and the advancement of education and religion, is one of the purposes in the general law of charity that is deemed beneficial to the community as a whole even though the class of beneficiaries eligible to receive a direct benefit from its activities does not include all members of the community, such as indigent members of the community, provided that the class is not so small that its relief is not of benefit to the community.

Rev. Rul. 69-545 also offers the following examples of qualifying and non-qualifying section 501(c)(3) hospitals:

- By operating an emergency room open to all persons and by providing hospital care for all those persons in the community able to pay the cost thereof either directly or through third party reimbursement, Hospital *A* is promoting the health of a class of persons that is broad enough to benefit the community. Furthermore, Hospital *A* is operated to serve a public rather than a private interest. Control of the hospital rests with its board of trustees, which is composed of independent civic leaders. The hospital maintains an open medical staff, with privileges available to all qualified physicians. Members of its active medical staff have the privilege of leasing available space in its medical building. It operates an active and generally accessible emergency room. Hospital *A* qualifies for exemption under IRC section 501(c)(3).
- Hospital *B* was initially established as a proprietary institution operated for the benefit of its owners. Although its ownership has been transferred to a nonprofit organization, the hospital has continued to operate for the private benefit of its original owners who exercise control over the hospital through the board of trustees and the medical committee. They have used their control to restrict the number of doctors admitted to the medical staff, to enter into favorable rental agreements with the hospital, and to limit emergency room care and hospital admission substantially to their own patients. These facts indicate that the hospital is operated for the private

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benefit of its original owners, rather than for the exclusive benefit of the public. Hospital B does not qualify for exemption under IRC section 501(c)(3).

In Eastern Kentucky Welfare Rights Organization v. Simon, 370 F. Supp. 325 (D.D.C. 1973), rev'd, 506 F.2d 1278 (D.C. Cir. 1974), vacated on other grounds, 426 U.S. 26 (1976), the court approved and upheld the validity of Rev. Rul. 69-545.

In Redlands Surgical Services v. Commissioner, 113 T.C. 47 (19XX), *aff'd*, 242 F.3d 904 (9th Cir. 20XX), the court held that the exempt organization, a wholly owned subsidiary of an exempt health care system that argued it met the operational test under IRC § 501(c)(3) because its surgery center activities furthered exempt purposes by promoting health and providing access to surgical care for the community based on medical need, had ceded effective control of the partnerships' and the surgery center's activities to for-profit parties, conferring significant private benefits on them. Therefore, it was not operated exclusively for charitable purposes within the meaning of IRC § 501(c)(3).

GOVERNMENT'S POSITION

In order to qualify under section 501(c)(3) of the Internal Revenue Code, an organization must be organized and operated exclusively for one or more of the purposes set forth in that section. ORG meets the organizational requirements of IRC section 501(c)(3); however, ORG does not operate for 501(c)(3) purposes.

Financial stability standard

While the courts upheld the validity of Rev. Rul. 69-545 in Eastern Kentucky Welfare Rights Organization v. Simon, the new ruling did not revoke Rev. Rul. 56-185 but merely modified it to include the community benefit standard. Thus, the financial stability standard continues to remain relevant although it is no longer the sole requirement for exemption. Though a health care organization is no longer required to operate to the extent of its financial ability for those not able to pay, doing so is a major factor indicating that the organization is operated for the benefit of the community.

During the examination, ORG claimed that the organization accepts patients without regards to the individual's ability to pay. However, ORG's primary activity involves seeing patients that are enrolled in a managed care plan. For the most part, ORG will refer patients who do not have insurance and who do not have the ability to pay to other health care organizations that receive governmental funding to provide free or low cost mental health care to the members of the community. On occasion, ORG may see patients who only require short-term care but do not have insurance if reasonable payment is agreed upon.

Additionally, despite listing a wide variety of insurances on its website, ORG does not explicitly indicate on its website that the organization accepts Medicare and Medi-cal (i.e. CO-65). Instead, the organization depends on Medicare and Medi-cal to refer patients to its therapists. Furthermore, ORG does advertise the fact that the organization is a nonprofit mental health care facility. Instead, ORG's website indicates that the organization charges fees based on the usual and customary fees for each profession and offers payment plans in cases of hardship. Conclusively, ORG has not made any attempts to advertise its

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services to low income individuals or individuals who do not have the ability to pay.

In addition, though ORG claims to offer non-billed consultations and pro-bono services through other community organizations, it was found during the examination that ORG has not provided any free consultations for the direct benefit of the patient (i.e. the consultation was not part of the therapist's normal course of business), nor has ORG actually provided free counseling sessions to members of the community through other organizations or by email.

Based on information submitted by ORG, fees were waived for 11 individuals in 20XX. However, records provided by ORG also show that the amount waived for each individual was, for the most part, minimal. Insurance payments were collected for seven of the 11 individuals, and patient payments were collected for six of the 11 individuals. Only four of the 11 individuals whose fees were waived received free counseling services (i.e. limited or no payments were received for services rendered).

Even so, on all occasions, an attempt is made to collect the maximum rate possible. Subsequent to failed attempts to collect, ORG will reconsider the patient's situation and will write off the loss as "waived fees." Consequently, waived fees resemble an allowance for doubtful accounts recognized by similar for-profit health care facilities.

Conclusively, ORG does, in actuality, accept patients based on the individual's ability to pay. Thus, ORG does not meet the financial stability standard because the organization does not operate to the extent of its financial ability for those who are unable to pay for services.

Community benefit standard

However, per Rev. Rul. 69-545, ORG is not required to care for indigent patients without charge or at rates below cost. By operating a mental health care facility open to all persons and by providing care for all persons in the community able to pay the cost for treatment (either directly or through third party reimbursement), ORG may be promoting the health of a class of persons that is broad enough to benefit the community. In this regard, ORG may qualify for tax exempt status so long as the organization meets the other requirements under IRC section 501(c)(3).

Nonetheless, additional standards must be met in order for ORG to qualify as a tax exempt entity organized for the benefit of the community. Rev. Rul. 69-545 establishes a community benefit standard that focuses on a number of factors to determine whether a hospital operates for the benefit of the community rather than for private interests.

Lack of an independent board of directors

In Rev. Rul. 69-545, control of a tax-exempt hospital by a board of directors composed of "independent civic leaders" was a significant factor under the community benefit standards. However, ORG is not controlled by an independent board of directors. Similar to the organization described as "Hospital B" in the revenue ruling, ORG operates under the direction of its original owner and his wife. Together, President and Secretary exercise 100 percent control over the organization's operations and financial

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decisions as the sole officers of the organization. Although officially organized as an entity exempt under IRC section 501(c)(3), the organization's internal arrangement includes, in actuality, no board interaction or oversight. President and Secretary, a husband-and-wife team, can legally establish a quorum based on ORG's current bylaws.

Lack of educational activities

Aside from hospital care provided on a nonprofit basis to members of the community, the organization described as "Hospital A" in Rev. Rul. 69-545 also conducted educational and research activities, which qualify as section 501(c)(3) activities that benefit the community. However, ORG does not offer any educational services to the community.

Following an unsuccessful attempt to conduct a seminar in the past, ORG concluded that people did not value free counseling. In lieu of free seminars, newsletters, and other community related activities, ORG created a website for the purpose of information dissemination. Subsequent to the commencement of this examination, ORG has expressed interest in expanding its website to include a wider variety of self-help material. Although the organization's future objectives have been taken into consideration during the examination, the organization's claim for expansion has been determined unreliable at this time.

Even if we were to accept the dissemination of self-help articles by means of the internet as an "educational activity" that qualifies for section 501(c)(3) status, expenditures for website maintenance are low, and updates on the organization's website have been scarce over the past 11 years. If the organization's community service activities have been concentrated on its website, then the organization has made little effort to maintain or expand its community service activities over the past 11 years.

Consequently, ORG does not meet community benefit standards under Rev. Rul. 69-545. ORG is operated by interested parties who serve to benefit from the revenue that is generated by ORG in the form of compensation for both therapy services and officer duties. Moreover, ORG does not conduct any educational activities for the benefit of the community.

Relief of the poor and distressed

Although ORG accepts a wide variety of managed care plans, the organization is not catering to low income or needy individuals. In 20XX, 93.46 percent of the organization's patients were covered by a managed care plan.

Even though we have not calculated the range of fees for which we would consider a patient as a low income individual in this situation, information submitted by ORG (i.e. patient accounts receivable records) indicates that a majority of the patients seen during the 20XX calendar year received patient care at a discount that was less than 50 percent of the usual and customary fees charged by ORG. Thus, based on ORG's definition of "minimal fee patients," ORG would not qualify as an organization that caters to low income patients.

While ORG recognized over \$ in discounts offered to patients during the year under examination, a majority of the discounts offered were provided as a part of each individual's insurance plan. Therefore, discounts offered by ORG were required by the managed care contracts established by ORG and the managed care companies. These discounts are identical to the discounts that are offered by comparable

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for-profit health care facilities.

Thus, ORG has not offered any evidence that differentiates the organization from any other for-profit psychiatric office. ORG does not cater to low income individuals; thus, the organization does not offer relief to the poor and distressed individuals of the community.

ORG resembles a typical private practice

Recognition of profit does not preclude an organization from definition as a nonprofit entity. In a similar manner, consistently incurring a net operating loss does not automatically qualify ORG as a nonprofit organization.

Because ORG does not receive any grants or conduct any fundraising activities, the organization relies fully on patient fees to fund its operations. Therefore, by accepting a wide variety of insurance plans, ORG's therapists are able to establish a wider patient base for the purpose of generating revenue. Income generated from patient fees result in direct payments in the form of wages to the organization's therapists and officers. During the year under examination, the organization accumulated \$ in patient fees but paid out \$ as wages to its therapists. ORG paid an additional \$ in wages to its officers for administrative support.

In essence, ORG is operating a typical private practice. Based on industry standards, therapists that are a part of ORG pay the organization for overhead costs (i.e. rent, therapy supplies, etc) based on a fee-split schedule. In turn, the officers of the organization maintain the offices of ORG for the benefit of the therapists.

In conclusion, ORG does not qualify as a community benefit organization. ORG operates a private practice for the benefit of the organization's therapists and officers. Per Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii), an organization must be established for public rather than for private interests in order to qualify for tax exemption under section 501(c)(3). Thus, ORG no longer qualifies as an organization exempt under IRC section 501(c)(3).

TAXPAYER'S POSITION

The taxpayer's position is not available at this time. The organization will be allowed 10 days to respond.

CONCLUSION

During the examination, it has been determined that ORG no longer qualifies as an organization exempt under IRC section 501(c)(3).

Revocation of the organization's exempt status is proposed effective January 1, 20XX. ORG is required to file Forms 1120 for the periods ending December 31, 20XX, 20XX, and 20XX.